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November 15, 2005

AGENDA ITEM 4

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

- I. SUBJECT:** Proposed Regulations: Service Credit Installment Payment Interest
- II. PROGRAM:** Retirement
- III. RECOMMENDATION:** Staff recommends the Benefits and Program Administration Committee recommend that the Board approve for publication the proposed regulatory amendments on the interest rates to be charged on installment payments for service credit purchases and contribution adjustments.

IV. BACKGROUND

The Public Employees' Retirement Law (PERL) provides CalPERS state, school and local contracting agency members the ability to purchase various types of service credit to enhance their retirement benefits. A member can purchase service credit by making a lump sum payment, installment payments, or a combination of the two. The initial lump sum cost of service credit purchases is determined under two basic cost calculation categories: Present Value, and Non-Present Value.

"Non-Present Value" service credit purchases include, but are not limited to: redeposit of withdrawn contributions; service prior to membership; CETA service; optional member service; mandatory arrears; temporary disability leaves of absence; and various other public service credit provisions.

"Present Value" service credit purchases include, but are not limited to: ARSC (Additional Retirement Service Credit) purchases; military service; educational and sabbatical leaves of absence; maternity and paternity leaves; and other eligible service credit purchase types.

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The CalPERS Board has determined that the deposit of contributions for Present Value service credit types calculated pursuant to Government Code section 21052 are intended to be cost neutral to employers. The Present Value costing method set forth in this section requires that the purchase payment be an amount "...equal to the increase in employer liability..." Thus, the interest charged on installment payments to purchase such service credit should equal the interest rate used by the actuaries to calculate the Present Value lump sum amount. This interest rate is the "actuarial interest rate" as specified in the proposed regulations text.

These proposed regulations make explicit the current CalPERS policies and practices for the calculation of interest on installment payments for all service credit purchases.

V. ANALYSIS:

The California Code of Regulations (CCR), Title 2, sections 575.1 and 575.2, establish the authority and conditions for members to make service credit purchases using installment payments. These sections provide that member installment payments must be uniform for each payroll period; may not be less than \$15 per month; and may not exceed 180 monthly payroll periods. These existing CCR provisions, however, do not include the interest rate(s) to be charged on the member installment payments.

Proposed Amendment to CCR Section 575.1

The proposed amendments to CCR section 575.1 would make explicit the interest rates which CalPERS would apply to all service credit purchase installment payments (except for State Second Tier to First Tier conversions, provided for in CCR section 575.2). This section's amendment would cover both Present Value and Non-Present Value interest rates, depending on the type of service credit purchased. This amendment would also make explicit the interest rates for specified Judges' Retirement System (JRS) and Judges' Retirement System II (JRS II) service credit purchases.

Specifically:

- The proposed CCR subsection 575.1(d) would establish for certain service credit purchases and contribution adjustments subject to Section 575.1, the interest applied on the unpaid balance shall be the member interest crediting rate (currently 6%, compounded annually) provided in Section 20178, in effect on the effective date of the member's election or contribution adjustment. This interest rate shall apply from the effective date of the service credit election or contribution adjustment through the completion of payments.
- The proposed CCR subsection 575.1(e) would establish for service credit purchases subject to Section 21052, the interest rate applied on the unpaid

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balance shall be the actuarial interest rate (currently 7.75%) used in the calculation of the benefit liability. This interest rate shall apply from the effective date of the service credit election or contribution adjustment through the completion of payments.

- The proposed CCR subsection 575.1(f) would establish for judges' service credit purchases subject to Government Code sections 75030.8 and 75506.5, the interest rate applied on the unpaid balance shall be the actuarial interest rate (currently 7.75%) used in the calculation of the benefit liability. This interest rate shall apply from the effective date of the service credit election or contribution adjustment through the completion of payments.

In addition, CCR section 575.1 will be amended to clarify that the interest will accrue as if the applicable interest rate remains in effect throughout the installment payment period until the completion of payments, consistent with existing service credit provisions.

If Board approval is received, the regulation adoption process requires:

- Publication in the California Regulatory Notice Register;
- A 45-day public comment period;
- Final Board approval; and
- Transmission to the Office of Administrative Law for filing with the Secretary of State and publication in the California Code of Regulations.

Proposed Amendment to CCR Section 575.2

Government Code section 21073.1(a) authorizes CalPERS members who elect to convert from State Second Tier retirement benefits to State First Tier retirement benefits to pay for the enhanced benefits, but does not specify the interest rate to be applied if installment payments are elected. Government Code section 21073.1(b) authorizes the Board to adopt regulations implementing the process and exempts such regulations from review by the Office of Administrative Law. However, the Board must transmit the regulations to the Office of Administrative Law for filing with the Secretary of State and publication in the California Code of Regulations. In 2000, the CalPERS Board took action to set the conditions for the installment payments for this conversion election by approving CCR section 575.2.

CCR section 575.2 applies solely to State Second Tier conversion installment payments and, like CCR section 575.1, does not currently specify the interest rate to be charged on member installment payments, but interest has historically been included and based on the member interest credit rate (6% compounded annually) provided in Government Code section 20178.

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The proposed amendment to CCR section 575.2 would add subsection (d) to provide that, for State First Tier service credit conversions, the interest applied on unpaid balances would be the member interest crediting rate as provided for in Government Code section 20178.

Attachment

Attached for reference is the proposed amendment text to the California Code of Regulations, title 2, sections 575.1 and 575.2.

VI. STRATEGIC PLAN:

This item supports:

Goal III by designing, developing and administering benefit programs and business processes that are innovative, effective, and valued by our members, employers and stakeholders, and

Goal IV by assuring that sufficient funds are available to pay benefits.

VII. RESULTS/COSTS:

No workload or cost impacts, because these regulatory amendments establish and continue current practice.

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Attachment:

Proposed Regulatory Language